

~~CONFIDENTIAL~~

THE WHITE HOUSE

WASHINGTON

December 16, 1986

MEMORANDUM FOR THE PRESIDENT

FROM: THE ECONOMIC POLICY COUNCIL

SUBJECT: Farm Bill Revisions

The Food Security Act of 1985 has been successful in making U.S. exports more competitive, particularly rice and cotton, which benefit from the generous marketing loan program. As price supports (loan rates) for crops such as wheat, soybeans, and feed grains are reduced, U.S. exports in these crops will also increase over the next few years.

The 1985 farm bill however did not address many of the existing problems of the Federal farm program structure and created some new ones.

The Economic Policy Council has identified a number of these problems and is presenting several potential remedies -- administrative and legislative -- for your consideration.

Some of the most serious problems in the farm program are:

- ° There are some very large payments as well as unfairness in the system. Some farmers have received checks of up to \$12 million from the Government. There is a \$50,000 limit on payments, but that only covers deficiency payments. Many other types of payments are available which are excluded from the limitation.

In addition, farmers are evading that \$50,000 limitation by dividing farms into trusts, holdings by children, and overlapping partnerships. Those farmers who do not "game" the system are placed at a disadvantage.

- ° Production decisions are increasingly being driven by the prospect of Federal payments, not market conditions. Most farmers cannot afford not to participate in Federal programs, because profits from sales to the market are a relatively small portion of income. Set-asides, designed to reduce production, are not the answer. They have hurt U.S. farm efficiency by spreading fixed costs over fewer acres and encouraged our competitors to expand production and take our markets.
- ° Because the cost of the program depends on how much is produced, there is still a great deal of unpredictability in budgeting. Rather than setting a level of assistance, our farm program operates like an entitlement program, open-ended. This is one of the reasons farm payments have increased from \$4 billion in 1981 to \$26 billion in 1986.

Declassify on:
OADR

~~CONFIDENTIAL~~

FARM BILL REVISIONS

The Council recommends that the Administration forward legislation seeking reform in the farm bill for two reasons:

- ° This will be the last opportunity for this Administration to attempt to address the troubling aspects of the farm programs in a non-election year atmosphere.
- ° The Congress itself will likely open up the farm bill. As they do so, the Administration should have its own approach on the table.

ILLEGIB

However, the Council believes we should be very careful not to make any legislative proposals that would jeopardize the agricultural talks of the Uruguay Round or reduce our leverage in those negotiations. Ultimately, we will not be able to solve our domestic farm problems without solving global farm problems.

Congressional Approaches

There are three general approaches that will likely be proposed by Members of Congress:

- ° The "Save the Family Farm Act" sponsored by Representative Gephardt and Senator Harkin would allow farmers to vote on mandatory supply controls and more than double the loan rates.
- ° Undoubtedly there will be attempts to extend the marketing loan programs to wheat, feed grains and soybeans. Secretary Lyng has the authority to administratively offer marketing loans in these crops but has not done so because of the cost, roughly \$2 to \$5 billion per year.
- ° Senators Boschwitz and Boren have introduced legislation that would "decouple" farm payments from production. Future payments would be made on an historical basis, such as acreage in production in 1986, rather than on current production. This would break the link between production and Federal payments, and take a major step in the direction of a more market-oriented agricultural sector.

AN ADMINISTRATION APPROACHObjectives for Reform

The Council identified the following objectives for a farm policy proposal:

- ° Ensuring fairness and restoring some sense of proportion to our agricultural policy;

CONFIDENTIAL

CONFIDENTIAL
-3-

- Reducing the dependency of farmers on government income supports;
- Eliminating the necessity for acreage reduction programs;
- Ensuring commodity price supports at or below market-clearing levels; and
- Establishing a long-term U.S. agricultural policy that strengthens our negotiating position in the GATT Round.

A Legislative Proposal

Rather than attempt to rewrite the entire farm bill, the Council recommends that we focus on three avenues of reform:

- Reducing budget exposure;
- Strengthening payment limitations; and
- Decoupling production decisions from payment eligibility.

The Council has developed a five-part legislative proposal that would affect wheat, feed-grains, cotton, rice and soybeans for the crop years 1988-1990. Specifically, the proposed legislation would:

1. Decouple crop production decisions from Government income support payments.

Producers would receive deficiency payments (including loan deficiency payments) based on historical acreage, without being required to plant the "program" crop on those acres.

The Council has looked at the question of whether farmers would be permitted to plant other crops on farm program acres. There are two possible approaches:

A. Do not permit any planting:

This would prevent farmers benefiting from "decoupled" payments from using the affected acres to plant any crops other than the crop on which payments are being made and to compete with farmers not benefiting from a federal program. It also would help reduce the current high stocks levels.

CONFIDENTIAL

C
-4-
CONFIDENTIALB. Permit a limited level of planting:

This would help distinguish decoupling from a set-aside approach. Allowing farmers to grow a new crop, a crop other than one historical payments are based upon, would introduce more market orientation. In addition, the principle of permitting planting of non-program crops would be established in the law when a new farm bill is written in 1990.

2. Limit direct payments per person.

Farmers are eligible to receive several types of direct payments, including deficiency, loan deficiency, marketing loan and land diversion payments in addition to proceeds from loans. Current law limits deficiency payments and land diversion payments to \$50,000 per person, with a separate \$200,000 limit, new for next year, covering marketing loan payments and loan deficiency payments.

Some agencies propose further tightening these limits. The advantages of this approach would be budget savings (up to \$300 million per year for an all-inclusive \$50,000 limit), reduced payments size and reduced production incentives for large farms.

The disadvantages are equally apparent: tight limits would eliminate the benefits of the programs for substantial numbers of larger farmers (especially cotton and rice farmers) and generate strong Congressional opposition that could jeopardize our other reform efforts. The options include:

- A. A \$50,000 limit per person for all direct payments.
- B. A \$100,000 limit per person for all direct payments.
- C. \$250,000 limit per person for all direct payments.
(current law)

3. Administratively and legislatively tighten the definition of "person" for purposes of the payment limitations.

The goal is to strive for consistency and fairness in the application of payment limitations by preventing farmers from dividing their farms into trusts and holdings by their children.

CONFIDENTIAL

~~CONFIDENTIAL~~

4. Reduce target prices by 10 percent per year through 1990.

Farm program outlays would decline by \$13 billion over the FY 1988 through FY 1990 period. This action would reduce incentive to overproduce and contribute to reductions of budget deficit. However, net cash farm income would be lower.

5. Provide more flexibility in establishing loan rates for program crops.

Currently, Secretary Lyng has the authority to reduce loan rates by no more than 5 percent per year, an authority that he has fully exercised. We would seek to permit administrative reductions of up to 10 percent per year. This would insure competitive U.S. prices, reduce incentives to produce for the loan itself, and make the decoupling provisions more effective.

-6-

DECISION

The Department of Agriculture will submit legislation that contains the following elements:

1. Decoupling crop decisions from Government income support payments, while:

_____ Not permitting the planting of any crop (except the affected program crop) on the acres covered by the historical payments; or

(supported by Treasury, Agriculture, Commerce, USTR and NSC)

_____ Permitting a limited level of planting of other crops on the acres covered by the historical payments.

(supported by State, OMB, and CEA)

2. Limit direct payments per person to:

_____ \$50,000 (supported by Treasury, OMB and CEA)

_____ \$100,000 (supported by Commerce, USTR and NSC)

_____ \$250,000 (current law) (supported by Agriculture)

The Council also unanimously recommends that the USDA legislation include the following elements:

3. Tightening the definition of person for purposes of the payment limitation;
4. Reducing the target prices by 10 percent per year through 1990;
5. Providing more flexibility in establishing loan rates for program crops.

_____ Approve _____ Disapprove

In addition, the Council strongly recommends that you personally communicate with the heads of government in the Summit countries and Australia that you are proposing legislative reforms of our domestic farm programs and point out to them that to have any chance of passing the legislation, you need their assurances that they will commit to engage in truly comprehensive negotiations in the agricultural portion of the Uruguay Round of the GATT.

CONFIDENTIAL

James A. Baker III
James A. Baker, III
Chairman Pro Tempore